offer but in its annual report for the year 1942 which was mailed to stockholders three days prior to the mailing of the offer. There respondent's profit for the year was stated to be equivalent to 49¢ per share of common stock after deduction of estimated taxes and after allowance for unpaid preferred dividends accrued in that year, as compared with 38¢ per share for the year 1941. The crux of Judge Kalodner's complaint seems to be that a similar arithmetical calculation was not made to show what respondent's earnings for the year 1942 were equivalent to per share of preferred stock (R. 49a-50a, 54a, 56a, 64a).

Respondent's annual report, however, contained the following information (R. 31a):

"CAPITAL

Capital stock:		
Preferred, 7 per cent. cumulative, par value $100 per share (redeemable at $115 per share and accrued dividends); authorized 15,037 shares, issued and outstanding 5,037 shares (cumulative dividends unpaid since April 1, 1931, amount to $82.25 per share	$ 503,700.00	
Common, authorized 500,000 shares, no par value, issued and outstanding 409,313 shares	409,313.00	
	913,013.00	
Surplus appropriated for preferred stock retired ($1,326,300.00 from capital surplus)	2,496,300.00	
Capital surplus	634,265.01	
Deficit from operations	*268,955.15*	3,774,622.86
		$4,314,495.64

* * * *

Net operating profit for the year	$ 235,751.73"

From the foregoing, it is apparent that preferred stockholders were fully advised as to the present status of their shares and if any wished to determine what respondent's net operating profit for the year was equivalent to per

share of preferred stock, he had only to divide that profit of $235,751.73, which was set forth in the report, by the number of shares outstanding, namely, 5,037, which was also set forth in the report. This was a simple arithmetical calculation which any stockholder could easily have made.

Judge Kalodner also appears to have felt that preferred stockholders should have been advised that their rights were prior to the rights of common stockholders (R. 57a-58a). But the very statement quoted above gave them the dividend rate, advised them that the dividends were cumulative, and amounted to $82.25 per share. That the preferred stock was prior to the common stock was apparent from its name as well as from each preferred stock certificate which contained a statement of the prior rights of the preferred stock.

Judge Kalodner also criticized the offer because it did not set forth, in detail, respondent's arrangements with White, Weld & Co. and with Mr. Wolfe. The offer did set forth, however, in so many words, that both would be compensated by respondent for their services. Messrs. Cullman and Cohen and Mr. Wolfe knew the detailed arrangements which had been made. Other stockholders, if interested in the details, could easily have inquired.

It is significant that Messrs. Cullman and Cohen, both long associated with respondent in the most responsible positions and who were intimately familiar with respondent's business and fully advised as to all the arrangements made by respondent in connection with its offer to its preferred stockholders, accepted the offer for the shares they owned. They could not have been defrauded. They knew as much about respondent's business, its history and its future prospects, and about its offer to its preferred stockholders, as anyone knew. With all this information they accepted the offer.

It is also of significance that despite the fact that Judge Kalodner's charges received considerable newspaper publicity and that Mr. Wolfe notified respondent's remaining preferred stockholders of the pendency of the suit, of the fact that plaintiff had disposed of his shares, and of the

possibility that remaining preferred stockholders might wish to intervene and prosecute the suit, no one, even to this day, has sought to intervene. In fact, respondent has not even received a complaint from anyone, anywhere, at anytime, concerning the offer in question, except, of course, the complaint made by Judge Kalodner in the *Speese* suit, where no issue as to the offer was before him.

Were there any basis for the charges made by Judge Kalodner, we may be sure such charges would have been asserted by some of the interested parties, particularly after the publicity which Judge Kalodner's criticism received.

Judge Kalodner also has made reference to purchases by Everett Meyer, president of respondent, of a large block of respondent's common stock in May, 1943. The fact is that this purchase was made by Mr. Meyer under an option received by him from a private party a year before. The option price was $3 per share and at the time Mr. Meyer purchased the stock its market price was about $6 per share, so that Mr. Meyer's reasons for making the purchase are obvious and entirely proper.

The foregoing facts are presented, although, as the Court below ruled, they probably are not relevant, because of the groundless and utterly uncalled-for charges of fraud gratuitously indulged in by Judge Kalodner and taken note of by the dissenting judges of the Court below, despite the fact that the Court had refused to hear counsel for respondent on the question (R. 126).

Although respondent was not called upon to answer, here, any charges of fraud because they are not germaine to this proceeding and were not germaine to the case before Judge Kalodner, nevertheless, for the reasons stated, we have deemed it proper to set forth the facts. Not only is fraud never presumed, but, we submit, the facts of this case demontrate, affirmatively, that respondent's actions were in all respects proper.

(19)

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Supreme Court of the United States

October Term, 1944.

No. 1187.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,

Petitioner,

vs.

WEBSTER EISENLOHR, INC.

PETITIONER'S ANSWER TO BRIEF FOR THE RESPONDENT IN OPPOSITION.

HIRSH W. STALBERG,
1800 Market St. Nat'l. Bank Bldg.,
Phila. 7, Pa.,
Attorney for Petitioner.

Martin & Lyle, 302 Penfield Bldg., Phila., Pa.

IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 1944.

No. 1187.

HARRY E. KALODNER, Judge of the District Court of the United States for the Eastern District of Pennsylvania,
Petitioner,

vs.

WEBSTER EISENLOHR, INC.,
Respondent.

PETITIONER'S ANSWER TO BRIEF FOR THE RESPONDENT IN OPPOSITION.

The respondent argues that the Petition for Certiorari was filed too late, contending that the time for filing the petition runs from the date of the order of the court below filed December 28, 1944, and not from the date of the issue of the Writ of Mandamus on January 24, 1945. This argument of the respondent is based upon the ground that the Writ of Mandamus is not a judgment or decree of the court below, but that its issue is a mere ministerial act performed by the Clerk of the Court.

The petitioner now contends that the definitive order addressed to the Trial Judge by the court below was that contained in the Writ of Mandamus. The order of December 28, 1944 merely states that "it is now here ordered, adjudged and decreed by this court that the prayer of the said petition be, and the same is hereby granted; and the clerk of this court is hereby directed to issue the writs prayed for." (R. 140-141.)

No order was made upon the Trial Judge (petitioner herein) by said order of December 28, 1944. The Writ of Mandamus, however, specifically ordered the Trial Judge and the other Judges of the District Court to "vacate, revoke, set aside and declare null and void and of no effect said order of June 9, 1943...." (R. 142.)

It is therefore contended that the order directing or commanding the Trial Judge to do something: i.e. the order contained in the Writ of Mandamus, is a reviewable order.

To put it differently, the command in the peremptory writ implemented the order of December 28, 1944 and consequently became a reviewable order.

There is a difference between the ordinary writs which are merely ministerial acts of the clerks, and the peremptory writ of mandamus. A writ of summons is directed to the sheriff or the marshal—who is *not* a litigant—and commands him to serve process upon the litigant; a writ of execution is directed to a sheriff or marshal—who is *not* a litigant—and directs him to execute upon the property of a litigant.

The peremptory writ of mandamus, on the other hand, is *directed to a litigant* and *commands the litigant* to do something. Viewed in that light, it is similar to an order or decree entered in an equity case, which is also a command *upon the litigant* (although usually a command to refrain from doing something, whereas the peremptory writ of mandamus commands the affirmative doing of an act).

Consequently, just as the commanding injunctive order to a litigant in an equity case is an order which is reviewable, so is the peremptory writ of mandamus an order which

is reviewable, whether considered alone or as implementing the order of December 28, 1944.

It is said in 38 C. J. 545, section 12 that "... mandamus is a remedy to compel action while injunction is a remedy to prevent action ...".

At 38 C. J. 546, section 15, it is said:

> "In the specific relief which it affords, a mandamus operates much in the nature of a bill in chancery for a specific performance, the principal difference being that the latter remedy is resorted to for the redress of purely private wrongs or the enforcement of contract rights, while the former generally has for its object the performance of obligations arising out of official station or specifically imposed by law upon respondent."

It follows that since the peremptory writ containing the definitive or implementing order was issued January 24th, and the petition for certiorari was filed April 21st of the same year, the petition was filed in time.

Respectfully submitted,

HIRSH W. STALBERG,
Attorney for Petitioner.

INDEX

	Page
Introductory statement	1
Opinion below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	4
Conclusion	14

CITATIONS

Cases:	
Atlas Bank v. *Nahant Bank*, 23 Pick. 480	6
Baird v. *Franklin*, 141 F. 2d 238	12
Cohen v. *Young*, 127 F. 2d 721	7
First National Bank v. *Flershem*, 290 U. S. 504	5
Hazel-Atlas Co. v. *Hartford-Empire Co.*, 322 U. S. 238	10
Honesdale Shoe Co. v. *Montgomery*, 56 W. Va. 397, 49 S. E. 434	6
Manufacturers Mutual Fire Insurance Co. v. *Hopson*, 176 Misc. 220, 25 N. Y. S. (2d) 502 (N. Y. Sup. Ct. (1940)), aff'd, 262 App. Div. 731, 29 N. Y. S. (2d) 139 (1941), aff'd, 288 N. Y. 668, 43 N. E. (2d) 71 (1942)	7
Naspo v. *Summit Sweets Shoppe*, 106 N. J. Eq. 49, 150 Atl. 199	6
Peterson, Ex parte, 253 U. S. 300	11
Roche v. *Evaporated Milk Association*, 319 U. S. 21	11
Supreme Tribe of Ben-Hur v. *Cauble*, 255 U. S. 356	9
United States Lines, Inc. v. *United States Lines Co.*, 96 F. 2d 148	6
Whitten v. *Dabney*, 171 Cal. 621, 154 Pac. 312	6
Winkelman v. *General Motors Corp.*, 48 F. Supp. 504	6
Young v. *Higbee*, No. 342, Oct., 1944, decided Feb. 26, 1945	7, 9
Statutes:	
Securities Act of 1933, Sections 11 and 12	12
Securities Exchange Act of 1934, Sections 9 (e), 18 (a), and 29 (b)	12
Trust Indenture Act of 1939, Section 302 (a) (1)	12

645636—45

Miscellaneous:
Hornstein, *Problems of Procedure in Stockholders' Derivative Suits* (1942), 42 Col. L. Rev. 574, 583–84 6
McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit* (1937), 46 Yale L. J. 421, 433–434 .. 6
Notes of the Advisory Committee on the Rules of Civil Procedure 6, 9
Rules of Civil Procedure:
Rule 23 (a) (1) 9
Rule 23 (a) (3) 9
Rule 23 (c) 4, 5, 8, 13
Rule 53 (b) 11
Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committee (1937), Pt. I, 691–704 6
Securities and Exchange Commission Rule X–10B–5 13

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1187

HARRY E. KALODNER, JUDGE OF THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA, PETITIONER

v.

WEBSTER EISENLOHR, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

INTRODUCTORY STATEMENT

The Securities and Exchange Commission presents this memorandum *amicus curiae*. Its interest in the question presented will appear in the reasons advanced in support of the petition.

OPINION BELOW

The opinion of the Circuit Court of Appeals is reported at 145 F. 2d 316. The District Court wrote no opinion.

JURISDICTION

The writ of mandamus was issued by the Circuit Court of Appeals on January 23, 1945. The petition for a writ of certiorari was filed on April 21, 1945.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1945.

QUESTION PRESENTED

In a pending class suit in a United States District Court, the court was advised that the interests of the plaintiff and of a substantial portion of the members of the class had been purchased by the defendant. There were *prima facie* indications of inadequacy of the disclosures made to the public members of the class and that defendant had given special inducements to counsel for the plaintiff. In these circumstances, did the court have discretion to inquire (through appointment of a special master) whether fraudulent or misleading practices or other misconduct had occurred in contravention of the purposes of the Rule of Procedure relating to dismissal or compromise of class suits?

STATUTE INVOLVED

No statute is involved, but the petition for a writ of certiorari involves the application of Rule 23 (c) of the Rules of Civil Procedure.

STATEMENT

An action was instituted in the District Court of the United States for the Eastern District of Pennsylvania against Webster Eisenlohr, a Pennsylvania corporation, on behalf of all its preferred stockholders, by one Speese, a preferred stockholder. The complaint alleged that control of the corporation had

been usurped through application of an erroneous interpretation of provisions of its by-laws respecting voting rights, and that the corporation was being managed to the injury of the preferred stockholders for the sole benefit of the common stock and a bank which controlled a large block of the common stock. It sought a determination that the exclusive voting power was vested in the preferred stock, and other appropriate relief (R. 15–20).

Issue was joined and an initial hearing was held in the District Court (R. 21–26, 43). Thereafter the corporation circularized its preferred stockholders, offering to purchase their shares, which had a redemption value of $197.25, for $150 (R. 4, 31, 34). At that price it purchased almost all the preferred stock outstanding, including the shares of Speese and other stockholders represented by his counsel (R. 4, 35, 75). Counsel for Speese was apparently instrumental in effecting many of the purchases, for which he was paid commissions of $7.50 per share by the corporation (R. 34, 112). Thereafter counsel for Speese informed the court that he no longer had a client, and no one appeared to continue prosecution (R. 5, 74–75). Upon learning that agreements to pay commissions and other pertinent facts had not been disclosed to the preferred stockholders to whom the offer was made, and that they might otherwise have been misled as to the value of their holdings, the court appointed a special master to make an investigation and report to the court "any facts ascertained by him pertaining to fraud, misconduct,

mismanagement and irregularities in the conduct of the affairs of the Defendant and/or the Offer to the Preferred Stockholders." (Pet. Br. Appendix).[1]

On petition of the corporation, the Circuit Court of Appeals for the Third Circuit issued a writ of mandamus requiring the District Court to vacate its order of reference[2] (R. 141–143). Prior to oral argument thereon, the corporation had redeemed the remaining shares of its outstanding preferred stock (R. 136). Review of the action of the Circuit Court of Appeals in issuing its writ of mandamus is sought in the instant proceeding.

ARGUMENT

It is our position that the action of the District Court in seeking to ascertain all the facts surrounding the purchase by Webster Eisenlohr, Inc., of its outstanding preferred stock was consistent with the court's duties under Rule 23 (c) of the Rules of Civil Procedure.

In a class action the rights of many persons who have not had opportunity to select their representatives are before the court. The situation is parallel

[1] The special master was directed to investigate *inter alia* "The question as to whether or not there was a violation of Rule X–10B–5 'Employment of Manipulative and Deceptive Devices' of the Securities and Exchange Commission." (R. 13.) The order of the Court was amended subsequent to the opinion of the court below to omit the quoted provision (Pet. Br. Appendix) and that portion of the order is not directly involved on this review. (See *infra* p. 13.)

[2] The argument was heard before the court sitting *en banc*. Biggs and McLaughlin, JJ. dissented from the majority view that the order here sought to be reviewed was improper.

to corporate reorganizations where many widely scattered individuals are often represented in court by persons who were either self-appointed or who have broad authority without the customary controls of an intimate lawyer-client relationship. In such cases courts must exercise a more pervasive supervision than would otherwise be required. This Court has emphasized that in corporate reorganizations the court stands "in a position different from that which it occupies in ordinary litigation, where issues are to be determined solely upon such evidence as the contending parties choose to introduce." *First National Bank* v. *Flershem*, 290 U. S. 504, 525. The court may not limit itself to information and issues presented to it by the litigants, since "every important determination by the court calls for an informed, independent judgment; and special reasons exist for requiring adequate, trustworthy information where the jurisdiction rests wholly upon the consent of the defendant who joins in the prayers for relief." *Id.* at 525. We note that in the instant case, the purchase of the plaintiff's shares, while it did not involve dismissal of the suit, left no adversary parties before the court. Nevertheless the mandate of the court below would foreclose in such a suit the searching inquiry which this Court has required in reorganization cases.

The requirement of Rule 23 (c) that no class action may be dismissed or compromised without the approval of the court is recognition of the necessity for

the exercise by the courts of a jurisdiction over class suits comparable to that over reorganizations. Even before the adoption of the federal rules many courts had refused to permit dismissal of class litigation on terms unfair to those on whose behalf the action was brought.[3] The dangers of fraud in the settlement of actions brought on behalf of a class are set forth in McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, (1937) 46 Yale L. J. 421, referred to in the notes of the Advisory Committee on the Rules of Civil Procedure.[4] As is there suggested, the most practical method of settling such litigation is through approval of a proposed settlement by the court, which may, "after examining all the circumstances, reach an independent decision on the fairness of the settlement" *Id.* at 433–34. As was pointed out in *Winkelman* v. *General Motors Corp.* 48 F. Supp. 504, 514 (S. D. N. Y.):

> A question of public policy had developed in actions of this type, due to the private and

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[3] *Whitten* v. *Dabney*, 171 Cal. 621, 154 Pac. 312 (1915); *Naspo* v. *Summit Sweets Shoppe*, 106 N. J. Eq. 49, 150 Atl. 199 (1930); and *Atlas Bank* v. *Nahant Bank*, 23 Pick. 480 (Mass. 1840), and *Honesdale Shoe Co.* v. *Montgomery*, 56 W. Va. 397, 49 S. E. 434 (1904). Cf. *United States Lines, Inc.* v. *United States Lines Co.*, 96 F. 2d 148 (C. C. A. 2, 1938).

[4] See also *Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees* (1937), Pt. I, 691–704; Hornstein, *Problems of Procedure in Stockholders' Derivative Suits* (1942) 42 Col. L. Rev. 574, 583–84.

> secret settlement of stockholders suits, made without Court review and without notice to other stockholders. Against that unsavory practice the corrective provisions of Rule 23 (c) were directed.

It is clear that this provision of the Rules was adopted "to secure not routine approval of a consent decree" but to assure supervision of the court for the protection of all persons on whose behalf the action was brought. *Cohen* v. *Young*, 127 F. 2d 721, 725 (C. C. A. 6).

In the instant case the action of the corporation in buying out the preferred stockholders, including the complainant, resulted for all practical purposes in settlement of the litigation. A court of equity, looking to the substance of the transaction, may not draw a distinction between settlements designated as such and settlements effected through the sale of securities. Cf. *Young* v. *Higbee*, No. 342, Oct., 1944, decided February 26, 1945. Indeed, evils of the sort which Rule 23 (c) was designed to cure may be effected as readily through settlements in the guise of sales of securities as through other modes of settlement.[5]

[5] See, e. g., *Manufacturers Mutual Fire Insurance Co.* v. *Hopson*, 176 Misc. 220, 25 N. Y. S. (2d) 502 (N. Y. Sup. Ct. 1940), *aff'd*, 262 App. Div. 731, 29 N. Y. S. (2d) 139 (1941), *aff'd*, 288 N. Y. 668, 43 N. E. (2d) 71 (1942), where the complainant's securities were purchased at a price greatly in excess of the market, the pleadings were withdrawn from the court files, and a stockholder who later discovered the suit and its "settlement" attempted to carry on the litigation but was apparently barred from so doing by the running of the statute of limitations.

Unless the protection to all members of a class whose rights are sought to be enforced purportedly afforded by Rule 23 (c) is to be rendered ineffective, any payments by a defendant to a person who had assumed to litigate on behalf of a class must be subjected to the scrutiny of a court.

The agreement between the litigants which resulted in the sale of the plaintiff's securities was a compromise which, under Rule 23 (c), the parties should have submitted to the court for its approval. Had this been done the court could have prevented the obviously unfair situation in this case where some preferred stockholders fared better than others [6] and where the attorney for the complainant stockholder received his compensation not by allowance of the court but by agreement with the defendant whereby the extent of his compensation depended on the number of preferred shares he could arrange to have sold pursuant to the defendant's offer (R. 112–113). Since the rule provides that the court may require that notice of the proposed compromise "be given to all members of the class in such manner as the court

[6] Since the offer to purchase at $150 was $47.25 less than the redemption value, presumably those preferred stockholders who accepted the offer received that much less per share than those whose shares were ultimately redeemed. (R. 4, 31, 34, 136.)

directs",[7] the court unquestionably could have required disclosure to all the preferred stockholders of all pertinent information relating to the settlement. However, in violation of the rule, the litigants presented the court with a *fait accompli*. The circumstances of the transaction pointed toward fraud practiced by the litigants upon persons whose rights were under the protection of the court. Indeed, there were indications that the complainant, or his counsel, had used the process of the court to further his own ends in violation of obligations owing to the other members of the class. Cf. *Young* v. *Higbee, supra.* It was within the power and indeed the duty of the court to prevent circumvention of the rule designed for the protection of the non-litigating members of the class and to investigate possible abuse of the court's process.

The Commission takes no position as to whether there was in fact any fraud or misconduct or whether, if inquiry were made, the circumstances revealed would warrant the court in acting for the protection of the members of the class affected. It is our position, however, that the court had the power to determine the facts and that if fraud or misconduct were

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[7] The requirement of notice may well have been mandatory here. Although the petitioner treats the action as a spurious class suit under Rule 23 (a) (3), it is by no means clear that it was not a true class action seeking to enforce common rights under Rule 23 (a) (1). *Cf. Supreme Tribe of Ben-Hur* v. *Cauble*, 255 U. S. 356, cited as an illustration of a class action under subdivision (1) by the Advisory Committee on the Rules for Civil Procedure.

found the court would not be powerless to give redress. Equity provides numerous remedies by which the court might frustrate misconduct by the defendant or breach of fiduciary duty by the plaintiff. Rescission, additional payments by the defendant to defrauded stockholders, payment by the complainant or its counsel to other members of the class of sums received in violation of fiduciary duties, or contempt proceedings might be applicable here.[8] This Court, in a case dealing with fraud perpetrated on a court, recently had occasion to discuss the flexibility of equitable procedure "to meet new situations which demand equitable intervention, and to accord all the relief necessary to correct the particular injustices involved." *Hazel-Atlas Co.* v. *Hartford-Empire Co.*, 322 U. S. 238, 248.

Determination of the appropriate relief is peculiarly within the area which should be policed by the district court before which the improper practices were committed. This requires a wide range of inquiry by that court, and where, as in this case, the interests of the litigants are not such as to provide a basis for an independent judgment, the court should be free to appoint its own agent to make a thorough examination of the situation. Certainly, if inquiry

[8] The petitioner urges that the prayer for receivership in the original complaint in the class suit affords a basis for possible relief. (Pet. Br. pp. 9–10; Cf. footnote 5 to dissenting opinion, R. 132–133.) In our view the court's power and duty to take appropriate action for the protection of members of the class should not be affected by the absence or presence of such prayer in the complaint.

into all the facts surrounding the settlement is within the power of the court, as we contend it must be, the circumstances of this case are "exceptional" within the meaning of the requirement of Rule 53 (b), relating to a reference to a special master. Cf. *Ex parte Peterson*, 253 U. S. 300, 312–314.

By issuing its writ of mandamus the Circuit Court of Appeals thwarted the District Court in its attempt to determine what action, if any, it should take. Petitioner urges that "interlocutory, discretionary orders of the district court are not subject to control or review by mandamus in an appellate court." If the majority of the court below were clearly correct in their conception of the duties of a district court with reference to disposition of a class suit by consent, our interest would not lead us as *amicus curiae* to question the availability of the extraordinary remedy of mandamus. Once it is recognized, however, that the district court has a duty to exercise an informed independent judgment and to insist upon appropriate action for the protection of members of the class affected, then we submit that such inquiry should not be impeded through interlocutory review. Mandamus or prohibition would be warranted only upon a clear showing of action in excess of jurisdiction. Even where action in excess of prescribed jurisdiction is alleged, "appellate courts are reluctant to interfere with the decision of a lower court on jurisdictional questions which it was competent to decide and which are reviewable in the regular course of appeal." *Roche* v. *Evaporated*

Milk Association, 319 U. S. 21, 26. Mere inconvenience of the litigants is not such a special circumstance as to justify issuance of the writ of mandamus. *Id.* at 31.

The question presented is of importance in connection with the protection of members of the investing public. It also involves the problem of the relative functions of courts and administrative agencies in the protection of the public interest. The statutes administered by the Commission do not vest it with exclusive standing to protect the interests of security holders. In many respects the purpose of the disclosure requirements in these statutes is merely to afford interested security holders a chance to protect their own rights.[9] Since in many instances security holders affected are scattered and the individual stake of any one of them is relatively small, the class suit is an important instrument for their protection. Congress has found that individual action by investors "for the purpose of protecting and enforcing their rights is rendered impracticable by reason of the disproportionate expense of taking such action."[10] To the extent that any decision

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[9] See Securities Act of 1933, Sections 11 and 12; Securities Exchange Act of 1934, Sections 9 (e), 18 (a), and 29 (b). Cf. *Baird* v. *Franklin*, 141 F. 2d 238 (C. C. A. 2, 1944), holding that the Securities Exchange Act of 1934 grants a right of action to persons injured by its violation even apart from any specific provision for civil liability. Provisions for civil liability are also contained in other statutes administered by the Commission.

[10] Trust Indenture Act of 1939, Section 302 (a) (1).

forecloses inquiry into the fairness of settlements of class suits, causes of action provided for injured investors in the statutes administered by the Commission are made less effective.

Both the majority and the minority opinions of the court below agreed that the District Court erred in undertaking to inquire into a possible violation of the Commission's Rule X–10B–5 pursuant to the Securities Exchange Act of 1934, applicable to fraud in the purchase of securities (R. 125–126, 136). This issue has been eliminated from the petition by reason of modification of the original order of the District Court. Nevertheless, it remains pertinent to suggest that the court below showed an unnecessary concern to protect the Commission from possible invasion of its administrative functions. Of course, we should not regard investigation of a violation of that rule as *per se* an appropriate function of the District Court; but since the same facts which might constitute a violation of the Commission's rule might also prove relevant to the court's duties under Rule 23 (c) of the Rules of Civil Procedure, we believe that there was no necessity for curbing the scope of the investigation as originally ordered. The subsequent modification of the District Court's decision does not completely eliminate this issue, since we believe that the overlapping character of the two issues may have been responsible in part for what appears to us an unduly restrictive conception by the court below of the duties of a court in which a class action is pending.

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be granted.

HUGH B. COX,
Acting Solicitor General.

ROGER S. FOSTER,
Solicitor,
MILTON V. FREEMAN,
Assistant Solicitor,
THEODORE L. THAU,
Special Assistant,
DAVID FERBER,
Attorney,
Securities and Exchange Commission.

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